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July 15, 2019

VIA EMAIL

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Control and Divestiture Proceedings (Federal Reserve Board Docket No. R–1662; RIN 7100–AF 49)

Dear Ms. Misback:

We appreciate the opportunity to provide comment to the Board of Governors of the Federal Reserve System (the "Board") on the above-referenced proposal (the "Proposal").[1] The Capital Group Companies ("Capital Group") is one of the oldest asset managers in the United States. Through our investment management subsidiaries, we actively manage assets in various collective investment vehicles and institutional client separate accounts globally. The vast majority of these assets consist of the American Funds family of mutual funds, which are U.S. regulated investment companies distributed through financial intermediaries and held by individuals and institutions across different types of accounts.

We support the proposal to revise the Board's regulations related to determinations of whether a company has the ability to exercise a controlling influence over another company for purposes of the Bank Holding Company Act (the "BHC Act")[2] or the Home Owners' Loan Act ("HOLA").[3] In particular, we applaud the Board's efforts to replace the current subjective, "facts and circumstances" assessment of whether a company exercises a controlling influence over a second company with an objective set of presumptions of control that will clarify whether certain fact patterns are likely to give rise to a controlling influence. We agree with the reasons for these revisions that are cited in the Proposal, including the desire to provide greater clarity for investors and to ensure consistency of decision-making by the Board. We believe that this increased transparency and consistency will reduce the regulatory burden for investors like us and facilitate our ability to make permissible

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[1] Control and Divestiture Proceedings, 84 Fed. Reg. 21634 (May 14, 2019).
[2] 12 U.S.C. 1841 *et seq.*
[3] 12 U.S.C. 1461 *et seq.*

investments in banking organizations. Accordingly, we urge the Board to implement the proposed revisions to the Board's regulations, with certain modifications as noted below.

1. **The Board should clarify its treatment of passivity agreements previously entered into between the Board and individual entities, as well as the Board's intended use of passivity agreements going forward.**

The Board should clarify how it intends to treat passivity agreements that conflict with the Proposal. By way of example, in August 2002, the Board authorized us to acquire up to 15 percent of any class of voting securities of a bank holding company or bank without being deemed to have acquired control of that institution under the BHC Act or the Change in Bank Control Act ("CIBC Act")[4] so long as the acquisition complies with certain conditions (the "2002 Passivity Agreement"). Several of the conditions set forth in the 2002 Passivity Agreement are similar to the proposed presumptions of control outlined in the Proposal. For example, similar to the Proposal, the 2002 Passivity Agreement provides that we will not be deemed to exercise a controlling influence of a bank holding company or bank under the BHC Act if, among other things, none of Capital Group or its subsidiaries, funds or accounts have any director, officer or employee interlocks with a bank holding company or bank. However, certain other conditions in the 2002 Passivity Agreement contain more stringent requirements than those outlined in the Proposal. Most importantly, the 2002 Passivity Agreement only authorizes us to acquire up to 15 percent of any class of voting securities of a bank, while the framework outlined in the Proposal would allow us to own up to 24.9 percent of any class of voting securities of a bank.

In light of the foregoing, we propose that that persons or entities who have entered into passivity agreements with the Board be given the opportunity to amend such agreements to make them consistent with the Proposal. We believe this will further the Board's stated purpose of improving consistency, as investors will be able to rely on the presumptions of control outlined in the Proposal instead of the individualized terms of passivity agreements previously entered into with the Board. The Proposal should not automatically supersede all pre-existing passivity agreements because such passivity agreements may contain provisions that extend beyond the scope of the Proposal. For example, the 2002 Passivity Agreement addresses the Board's treatment of Capital Group under both the BHC Act and the CIBC Act, whereas the Proposal addresses the BHC Act only. Accordingly, the Board should establish a procedure by which entities that have previously entered into passivity agreements with the Board can enter into negotiations with the Board to amend such agreements, but the Proposal should not automatically supersede all passivity agreements currently in place with the Board.

In addition, the Board should specify whether it will continue to require entities to enter into passivity agreements after the Proposal becomes effective. The Proposal does not discuss the use of passivity agreements. In light of the Board's desire to make the control framework more transparent and the application of such framework more consistent, we believe that entity-specific passivity agreements should no longer be required so long as the company does not trigger any of the presumptions of control.

[4] 12 U.S.C. § 1817(j).

2. The Board should eliminate any conflict between the presumptions of control in the Proposal and those in the CIBC Act.

Investors like us must comply with both the BHC Act and the CIBC Act. From a practical perspective, we will not benefit from the Proposal if we continue to be subject to the control framework set forth in the CIBC Act. Under the CIBC Act, persons acquiring control in a bank or bank holding company must provide prior notice to the Board before acquiring control of a state member bank or bank holding company.[5] A person acquires "control" of a state member bank or bank holding company when it acquires ownership, control or the power to vote 25 percent or more of any class of voting securities of the banking institution.[6] Importantly, Regulation Y contains a rebuttable presumption of control for purposes of the CIBC Act in the event a person acquires ownership, control or the power to vote 10 percent or more of any class of voting securities of a banking institution, if certain other conditions are met.[7] Therefore, although the control framework outlined in the Proposal would permit investors to own up to 24.9 percent of any class of voting securities of a bank or bank holding company, investors would continue to be restricted by the CIBC Act's presumption of control if the investor owns, controls or has the power to vote 10 percent or more of any class of voting securities of the banking organization.

To streamline the regulations applicable to entities that invest in banks and bank holding companies, we propose revising Section 225.41(c) of Regulation Y to make the definition of "acquisition of control" and the related rebuttable presumption of control under the CIBC Act consistent with the Proposal. The existing control framework in the CIBC Act is similar to that in the BHC Act and therefore, the Board should be consistent in its interpretation of such frameworks. This consistency is particularly important in light of the Board's proposal to add a new section to Regulation Y that would make the proposed definition of control over securities consistent for all purposes under Regulation Y, including in the context of notices pursuant to the CIBC Act.[8] Most importantly, however, this approach would eliminate the duplication of the CIBC Act and the BHC Act, which if allowed to persist would require investors like us to comply with the more restrictive presumptions of control set forth in the CIBC Act instead of those outlined in the Proposal.

We acknowledge that the CIBC Act is not an express prohibition on the ownership of 10 percent or more of a class of voting securities of a banking institution; instead, the Act just requires that the entity proposing the acquisition of such an interest provide prior notice to the Board. In practice, however, submitting the notifications required by the CIBC Act is quite burdensome and has the effect of limiting our investments in banks and bank holding companies. Therefore, if the control framework set forth in the CIBC Act continues to apply to investors like us, our ability to make permissible investments in banks and bank holding companies will remain substantially limited.

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[5] 12 C.F.R. § 225.41.
[6] *Id.*
[7] *Id.*
[8] *See* Control and Divestiture Proceedings, 84 Fed. Reg. 21634, 21650 (May 14, 2019).

3. **The Board should make certain modifications to the proposed presumption of control concerning business relationships.**

One of the presumptions of control that the Board proposes under the new framework is whether there are significant business relationships between the first company (as defined in the Proposal) and the second company (as defined in the Proposal). Under the Proposal, the Board will measure the significance of such business relationships by determining whether the first company or any of its subsidiaries enters into transactions or has business relationships with the second company or any of its subsidiaries that generate in the aggregate a certain percentage of the total annual revenues or expenses of the first company or the second company, each on a consolidated basis.

a. **The Board should eliminate the requirement that the revenues and expenses of the first company be measured for purposes of determining the significance of business relationships.**

We propose eliminating the requirement that the revenues and expenses of the first company be considered when determining the significance of the business relationships between the first company and the second company. We agree with the Board that major customers and suppliers of a company can "exercise considerable influence over the company's management and policies, especially when combined with a sizeable voting investment, by threatening to terminate or change the terms of the business relationship."[9] However, the first company only has the ability to influence the second company's management if the second company views the first company as a significant customer or supplier. In other words, if the business relationship between the companies constitutes an immaterial percentage of the second company's expenses or revenues, the second company is unlikely to feel pressure to change its policies in response to the first company. This will be true even if the companies' relationship constitutes a large portion of the first company's revenues or expenses. Therefore, the significance of the business relationship should be measured from the second company's perspective alone, and the test for the relevant presumption of control should focus only on the extent to which the relationship impacts the revenues and expenses of the second company.

b. **The Board should expressly exclude debt securities when measuring the size of the business relationships between two companies.**

The Proposal does not specify the extent to which debt securities will be considered when determining the size of business relationships between the first company and the second company. This will lead to uncertainty for investors seeking to make permissible investments in banks and bank holding companies, and likewise for banks and bank holding companies seeking to raise capital. In light of the foregoing, we propose expressly excluding debt securities from the business relationship calculation, provided that such securities are (i) issued in a public or private offering to multiple investors, where the price and key terms are standardized across investors and not privately negotiated between the first company and the second company, or (ii) purchased from a third party in the secondary market. This will

[9] *Id.* at 21638.

give banks and bank holding companies the flexibility to raise capital, and investors the flexibility to participate in such capital raises.

We acknowledge that if debt securities are excluded from the quantitative portion of the business relationship test, they would also be excluded from the qualitative portion of the business relationship test. The qualitative portion of the business relationship test provides that the Board will presume control if the first company controls 10 percent or more of any class of voting securities of the second company and the business relationships between the companies are not on market terms.[10] We believe the qualitative portion of the business relationship test should continue to apply to transactions involving debt securities because if the terms of the documents underlying the debt securities are more favorable than market terms, it is likely that the first company has the ability to exert significant influence over the second company. Accordingly, as indicated above, we propose that debt securities only be excluded from the business relationship test only if such securities are (i) issued in a public or private offering to multiple investors, where the price and key terms are standardized across investors and not privately negotiated between the first company and the second company, or (ii) purchased from a third party in the secondary market.

Although there may be scenarios where the ownership of debt securities would enable a company to exercise control over another company, we believe the Proposal adequately addresses these circumstances. For example, the first company could be deemed to control the second company if the documents underlying the debt securities contain onerous restrictions on the second company's ability to manage its business, beyond what is typical in documents governing a standard debtor-creditor relationship. Under the Proposal, the Board will presume control if the first company controls five percent or more of any class of voting securities of the second company and the first company has a limiting contractual right with respect to the second company.[11] In addition, the ownership of certain debt that has equity-like characteristics could allow the first company to own more than one third of the second company's total equity before triggering a presumption of control. However, the Proposal contains a provision that would require debt that is "functionally equivalent to equity" to be treated as equity for purposes of calculating the first company's total equity percentage in a second company.[12] These proposed provisions would capture any debt securities that are likely to allow one company to control another. Therefore, it is unnecessary to include debt securities in the presumption of control concerning business relationships.

4. The Board should not adopt different presumptions of control for widely held companies and closely held companies.

Question 28 of the Proposal asks whether the Board should create different presumptions of control for widely held companies and closely held companies. We agree with the Board that "[i]ncorporating these distinctions in the presumptions could greatly increase the complexity of the proposal, and could make the presumptions more difficult to

[10] *Id.* at 21659, 21664.
[11] *Id.* at 21658, 21664.
[12] *Id.* at 21660, 21665.

apply in practice."[13] Therefore, we support the approach taken by the Board whereby the same presumptions of control would apply to both widely held and closely held companies.

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We truly appreciate the opportunity to comment on the Proposal. If you have any questions regarding our comments, please feel free to contact Donald H. Rolfe at (213) 615-0457 or Katherine Z. Solomon at (213) 615-0956.

Sincerely,

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[13] *Id.* at 21646.